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SIPDIS

FOR SECRETARY BODMAN FROM CDA ASQUINO
DEPT FOR EB/ESC; EUR/SNEC (MANN); EUR/CACEN (MUDGE)

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TAGS: [EPET](#) [ENRG](#) [AJ](#) [GZ](#) [KZ](#) [ECONOMIC](#)

SUBJECT: KAZAKHSTAN: ENERGY SCENESETTER FOR SECRETARY
BODMAN'S MEETING WITH FOREIGN MINISTER SHKOLNIK AT
US-KAZAKHSTANI ENERGY PARTNERSHIP, SEPTEMBER 8

REF: ALMATY 1944

Classified By: CHARGE MARK ASQUINO FOR REASONS 1.4(B) and (D)

1. (C) SUMMARY: In advance of your planned meeting with Energy Minister Shkolnik, Embassy Almaty wanted to offer background on the most pressing issues in the US-Kazakhstani energy dialogue and suggest key issues where your engagement could be crucial. They include the following:

Achieving a GOK-GOA IGA on transporting Kazakhstani oil into BTC (Kazakhstani Caspian Transport System-KCTS) that is fair to both government partners and private investors alike; Finalizing CPC expansion at terms advantageous to private and government consortium partners; Making the tender process, both for sub-contracts and new offshore blocs, as fair and as transparent as possible.

For a broader outline of hydrocarbon development in Kazakhstan, please see reftel. END SUMMARY.

Talking Points

2. (C) During your meeting with Energy Minister Shkolnik, you may wish to raise some of the following points in priority order:

-- We understand that Kazakhstan and Azerbaijan would like to sign an IGA to move oil through BTC, the so-called Kazakhstani Caspian Transport System (KCTS), at the October 4-7 KIOGE Oil and Gas Show in Almaty. We support this effort. However, the IGA must respect investor interests and be similar in spirit to the BTC agreement. It must include tax stability, international maritime standards, and parliamentary ratification. A follow-on Host Government Agreement (HGA) is no less important and must also respect investor rights.

-- We understand that progress has been made on CPC expansion, though important issues still remain. As with KCTS, any expansion agreement must respect the interests of private investors and state actors alike and prevent any one group from gaining dominance. The USG supports a timely resolution respecting the interests of all parties, both private and state shareholders.

-- We hope that any new tender process, whether for new acreage or for subcontracts on existing projects, will be transparent and give all capable companies fair access. We understand that ConocoPhillips would like to participate a tender for the North Sultan offshore Caspian field. ConocoPhillips is a first-rate, integrated oil company with expertise in developing offshore gas fields. In another matter, American oil services company McDermott, in coalition with Kazakhstani (Kazstroysevis) and British partners (AMEC), is competing for a "hook-up and completion tender" at the Kashagan off-shore field. While the ultimate decision lies with Kashagan operator AGIP-KCO, we hope the GOK will use its dual role as consortium partner (via state oil producer's Kazmunaigas' 8.33%) and regulator to ensure a fair, transparent process.

KCTS

3. (C) Our KCTS private sector energy contacts here are worried that the GOK is trying to walk back the IGA that was nearly signed during the BTC opening in Baku in May. They claim, with good reason, that the GOK does not merely want clarification. Instead, it is trying to abandon two important concessions to the North Caspian Shippers: tax stability and ratification of the agreement by the Kazakhstani parliament. The shippers, which include US companies ExxonMobil and ConocoPhillips, are members of the AGIP-KCO (Kashagan) consortium, which will be the main customer for KCTS. One AGIP-KCO partner says that he has lost faith in the ability of KMG Transport Chief Kaigeldy Kabyldin to deliver and win

interagency battles against the Ministry of Finance, the main enemy of tax stability. Our KMG working-level transport

contacts confirm that they lost the battle over taxes in the days just before the planned KCTS IGA signing in Baku in May.

Tax stability is important not only to safeguard the commercial terms of the agreement from future legislation, but also to attract international financing to the project.

14. (C) The North Caspian Shippers also worry that getting the oil to the port of Aktau or to the planned port of Kuryk from Kashagan will cost them dearly. Consequently, it is important that a follow-on HGA provide adequate protection and protect investors. Our KMG contacts hinted at serious differences between them and the shippers over getting the oil from the wellhead at Kashagan to the Caspian.

CPC Expansion

15. (C) Shell's Kazakhstan country representative Martin Ferstl reported that the next CPC shareholders meeting, to include Minister Shkolnik and his Russian counterpart, Khristenko, is planned for mid-September. Battle lines are largely drawn between private shareholders, including US companies ExxonMobil and Chevron, and the GOR. Kazakhstan has, in the view of some, supported Russia, though others hope that President Nazarbayev will ultimately seek a compromise or support private shareholders.

16. (C) Issues over managerial control still prevent inking an expansion deal. Namely, the GOR still has not agreed to a proposal to appoint management secondees in line with equity in return for giving up its demand to create a CPC-Russia board of directors. Such a board would be open to manipulation and take over by Russia, Kazakhstan, Oman and one other partner, and is a redline for the private shareholders. While agreement seems to have been reached on tariffs for capital expenditures, the private shareholders, according to Ferstl, rejected GOR demands for variable tariffs on operating expenses. Chevron Eurasia Business Chief Guy Hollingsworth told us that expansion approval should come no later than December 2005, otherwise the project will seriously fall off schedule.

New Tenders

17. (C) US companies may face challenges in obtaining fair access to offshore Caspian tenders and related subcontracts. New legislation gives KMG a 50% share in all new tenders plus the option to pick a "strategic partner" to develop blocs. Lawyers here report that the law leaves it unclear whether a "strategic partner" will be chosen competitively or through sweetheart deals.

18. (C) ConocoPhillips earlier voiced fears to us that it will lose out on competing for the North Sultan offshore Caspian bloc, which may hold 4-5 bn. barrels in proven or probable reserves, to a combination of Shell and Nelson Resources. We have also observed increasing contact between Shell and Nelson since late 2004. Nelson Resources is believed by most oil analysts here to be linked to Timur Kulibayev, presidential son-in-law and KMG First Vice-President. Kulibayev, in fact, is the real power at KMG, not the nominal president.

19. (C) In another tender, US oil services giant McDermott is competing with its Kazakhstani and British partners for a Kashagan hook-up and finishing project, whose first stage is estimated at \$70 million. Although AGIP-KCO, the Kashagan operator, will make the ultimate decision, we believe that KMG, both as regulator and consortium partner, will exercise its unique influence in picking a winner. In the past AGIP-KCO has favored fellow Italian companies; as a result, 27% of all subcontracts have gone to Italians, with US companies a distant second with 16%. McDermott has sought our advocacy. We see your meeting with Minister Shkolnik as a perfect opportunity to emphasize not only our expectations of a fair tender process, but also the top-notch reputation of McDermott in the oil services industry.
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